ANNUAL REPORT

File

Riverside
Yarns Limited

1977

RIVERSIDE YARNS LIMITED

Directors	J. BOECKH D. M. DEACON S. E. EDWARDS, Q.C. A. GOLD WM. W. LAIRD, Q.C. E. LAWRENCE J. WEIR
Officers	WM. W. LAIRD, Q.C. Chairman E. LAWRENCE President S. E. EDWARDS, Q.C. Secretary R. SONES General Manager O. LANGLAIS, JR. Treasurer-Controller
Head Office and Plant	Cornwall, Ontario
Bankers	ROYAL BANK OF CANADA THE TORONTO DOMINION BANK
Solicitors	FRASER & BEATTY
Transfer Agents and Registrars	NATIONAL TRUST COMPANY Toronto
Auditors	THORNE RIDDELL & CO. Chartered Accountants Brockville, Canada
Annual Meeting	June 29, 1978—11:00 a.m. Head Office, Cornwall, Ontario

RIVERSIDE YARNS LIMITED

REPORT TO THE SHAREHOLDERS

1977 was a year of solid achievement for your company. During the early part of the year, the sale of equipment and building at the Cambridge site was completed permitting management to concentrate all of its efforts on the operation of the Cornwall texturing plant. During this same time period the Canadian Government took a number of steps to limit imports of garments, fabrics and yarns. As a result of these measures, garment imports in 1977 were reduced by a third from 1976. Yarn and fabric imports of polyester were controlled more effectively. Riverside Yarns was able to operate at capacity during most of the year and completed a major plant expansion.

Production volume increased by 67% over 1976 levels (from both Cambridge and Cornwall plants) to 10.5 million pounds. Our domestic market share increased from 15% to 21%. A significant factor in achieving this increased market penetration was major gains made in product quality. We believe our textured yarn quality is now unexcelled.

As never before, fashion changes in the market place demand that we be able to supply a wide variety of products. Until mid 1976 we had a single product line based on 150 denier polyester for circular knit end uses. During the past year this has been increased to nine basic product lines as a result of an aggressive product development program. We anticipate that a high level of product diversification will remain a way of life and that production will be increasingly directed towards markets not previously available to us.

Major improvements in product yields, efficiencies and costs were realized during the year. All of our Scragg machines were converted to friction texturing by mid year, and committments made for the purchase of eight Barmag texturing machines, and related equipment, as agreed upon in our contract with DuPont. These machines are of a new generation of texturing equipment and the first of their kind in Canada. By year end a building expansion of 26,000 sq. ft. (making in all 94,000 sq. ft.) was completed and three of the new texturing machines were in operation. When in full operation in mid 1978, our expanded plant will have three times the capacity of the original Cornwall operation. It will be the largest, and we believe, the most efficient texturing operation in Canada.

Our labour force has grown from fewer than 120 at the beginning of 1977 to about 200 employees by year end. During this period plant management has been strengthened by a number of appointments which place us in a position to face the challenges of 1978 with confidence.

During the coming year we expect a substantial increase in shipments.

On behalf of the Board of Directors.

E. LAWRENCE
President

RIVERSIDE YARNS LIMITED

(Incorporated under the laws of Ontario)

BALANCE SHEET AS AT DECEMBER 31, 1977

Assets

	1977	1976
CURRENT ASSETS		
Cash and short term deposits		
Unrestricted (note 1(f))	$ 586,517	$ 684,710
Restricted to repayment of fixed asset financing (note 6(b))	240,500	
Accounts receivable	102,612	369,166
Income taxes under appeal		25,200
Inventories	4,684	34,688
Prepaid expenses and deposits	171,047	172,744
Machinery and equipment held for sale		35,000
	1,105,360	1,321,508
CASH AND SHORT TERM DEPOSITS restricted to repayment of 8% debenture (note 6(b))	200,000	
FIXED ASSETS (note 3)		
Machinery and equipment and leasehold improvements	7,313,812	3,939,145
Less accumulated depreciation	1,232,780	402,395
	6,081,032	3,536,750
Deposit on machinery and equipment	79,988	
Land and building held for sale		111,478
	6,161,020	3,648,228
DEFERRED FINANCING CHARGES	79,488	93,465
	$7,545,868	$5,063,201

Liabilities

	1977	1976
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 386,601	$ 680,419
Royalties payable		591,729
Income and other taxes payable	175,737	23,067
Principal due within one year on long term debt (notes 4(f) and 6(b))	1,107,928	369,114
	1,670,266	1,664,329
LONG TERM DEBT (note 4)	6,026,275	3,916,600
Total liabilities	7,696,541	5,580,929

Capital Stock and Deficit

	1977	1976
CAPITAL STOCK (note 5)		
Authorized		
120,000 Class A $.50 cumulative convertible voting shares without par value		
1,500,000 Common shares without par value		
Issued		
120,000 Class A shares; 170,000 Common shares	358,000	358,000
DEFICIT	508,673	875,728
	(150,673)	(517,728)
	$7,545,868	$5,063,201

Approved by the Board

E. LAWRENCE, Director
WM. W. LAIRD, Q.C., Director

RIVERSIDE YARNS LIMITED

STATEMENT OF INCOME
Year ended December 31, 1977

	1977	1976
Revenues	$4,649,616	$4,693,738
Processing and administrative expenses	3,125,946	4,574,326
Income before undernoted items	1,523,670	119,412
Depreciation	820,582	447,035
Interest on long term debt	473,910	451,808
Amortization of deferred financing charges	26,452	30,423
Other interest	67,467	23,985
Deferred pre-production charges written off		569,500
	1,388,411	1,522,751
Income (loss) before income taxes and extraordinary items	135,259	(1,403,339)
Income taxes	57,241	(131,900)
Income (loss) before extraordinary items	78,018	(1,271,439)
Extraordinary items (note 8)	289,037	(189,663)
NET INCOME (LOSS)	$ 367,055	($1,461,102)
Earnings (loss) per common share (note 5(e))		
Income (loss) before extraordinary items	$ .11	($7.83)
Net income (loss)	$1.81	($8.95)

STATEMENT OF DEFICIT
Year ended December 31, 1977

	1977	1976
RETAINED EARNINGS (DEFICIT) AT BEGINNING OF YEAR	($ 875,728)	$ 615,374
Net income (loss)	367,055	(1,461,102)
	(508,673)	(845,728)
Dividends on Class A shares (arrears, note 5(d))		30,000
DEFICIT AT END OF YEAR	$ 508,673	$ 875,728

RIVERSIDE YARNS LIMITED

STATEMENT OF CHANGES IN FINANCIAL POSITION

Year ended December 31, 1977

	1977	1976
WORKING CAPITAL DERIVED FROM		
Operations		
Income before extraordinary items	$ 78,018	
Add depreciation, amortization and income taxes which do not involve working capital	879,075	
	957,093	
Fixed assets		
Proceeds from disposal	128,375	$ 169,955
Other		124,567
		294,522
Proceeds from long term debt	3,247,928	
Gain on settlement of certain liabilities (note 8)	248,869	
Extension on commencement of principal repayment of 14¾% debenture		333,400
	4,582,265	627,922
WORKING CAPITAL APPLIED TO		
Operations		
Loss before extraordinary item		1,271,439
Items not involving working capital		
Depreciation and amortization		(477,458)
Deferred pre-production charges written off		(569,500)
Deferred income tax reduction		131,900
		356,381
Additions to fixed assets	3,453,622	457,310
Deferred financing charges	12,475	
Reduction of long term debt	1,138,253	437,400
Cash and short term deposits restricted to repayment of 8% debenture (note 6(b))	200,000	
Dividends on Class A shares (arrears, note 5(d))		30,000
	4,804,350	1,281,091
INCREASE IN WORKING CAPITAL DEFICIENCY	222,085	653,169
WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF YEAR	(342,821)	310,348
WORKING CAPITAL DEFICIENCY AT END OF YEAR (note 4(f))	$ 564,906	$ 342,821

RIVERSIDE YARNS LIMITED

NOTES TO FINANCIAL STATEMENTS

December 31, 1977

1. SUMMARY OF SIGNIFICANT ACTIVITIES

(a) The modification program undertaken in 1976 for the Cornwall plant was completed during the year.

(b) The agreement of December 1, 1976 effective January 1, 1977 with the company's customer, DuPont of Canada Limited ("DuPont") was replaced by a June 22, 1977 agreement (see note 6). The company's evaluation of the terms of this agreement are that it will result in net income in 1978 and will provide sufficient cash to repay the amounts due in 1978 with respect to the debentures, term bank loans and any related necessary future fixed asset financing. The agreement will effectively provide sufficient cash to repay secured long term debt.

(c) Arrangements were made with a Canadian bank to finance the fixed asset purchases to December 31, 1977 which were necessary because of the June 22, 1977 agreement. A further line of credit with such bank is available to the company in amounts sufficient to enable the company to meet its fixed asset accounts payable and commitments at December 31, 1977 (see notes 4 and 7(c)).

(d) The terms of the 8% debenture were amended to accelerate the principal repayments and eliminate certain of the restrictive covenants (see note 4(e)).

(e) In March, 1978 the company received permission from the 14¾% debenture holder to fully repay the debenture on May 1, 1978. The company will make this payment and the Canadian bank referred to in (c) above has agreed to provide the necessary funds (see note 4(d)).

(f) Subsequent to December 31, 1977 an amount of $117,220 related to proceeds from disposal of fixed assets in 1977 and held by a trustee was released to the company. This amount is included in unrestricted cash and short term deposits.

2. ACCOUNTING POLICIES

(a) Inventories
Inventory at December 31, 1977 consists of raw materials valued at the lower of cost and replacement cost.

(b) Fixed assets
Fixed assets are located in Cornwall and are stated at cost. Depreciation is provided over the estimated number of years during which the assets can economically contribute to earnings.

Prior to 1977, depreciation on such fixed assets was provided using the following rates and methods:

Major machinery and equipment — 20% straight line (reduced proportionately when not in use)
Minor machinery and equipment — 10% straight line
Leasehold improvements — 10% straight line

Commencing January 1, 1977 the company changed its estimates of useful life for depreciating fixed assets such that the December 31, 1976 net book value of fixed assets and the cost of subsequent additions are depreciated on a 20% straight line basis in order to provide a proper matching of expense against revenues under its agreement effective January 1, 1977 with DuPont (see note 6).

(c) Deferred financing charges
Financing charges are amortized, based on the principal outstanding, over the life of the related debt.

3. FIXED ASSETS

	1977			1976
	Cost	Accumulated depreciation	Net	Net
Machinery and equipment	$7,271,345	$1,229,885	$6,041,460	$3,528,675
Leasehold improvements	42,467	2,895	39,572	8,075
	$7,313,812	$1,232,780	$6,081,032	$3,536,750

4. LONG TERM DEBT

	1977	1976
12% Mortgage loan repaid in 1977		$ 35,714
Non-interest bearing agreement payable $30,000 annually commencing in 1978 (see (a) below)	$ 90,000	
8% Agreement payable $50,000 annually plus interest commencing January 14, 1978 (see (a) below)	150,000	
10½% Redeemable subordinated debentures, due October 31, 1980 (see (b) below)	750,000	750,000
Term bank loans, at bank prime rate plus 1¼%, each payable in sixty equal monthly instalments plus interest commencing in the month following installation of the related fixed asset (see (c) and (e) below)	2,368,000	

	1977	1976
Fixed asset accounts payable to be financed by term bank loans as above	567,928	
14¾% Debenture, payable $41,675 monthly plus interest, commencing May 15, 1977 and maturing April 15, 1982 (see (c) and (d) below)	2,208,275	2,500,000
8% Debenture, non-interest bearing to December 15, 1979, payable $600,000 December 15, 1979 and thereafter $12,500 monthly including principal and interest commencing January 15, 1980 and maturing December 15, 1982 (see (c) and (e) below)	1,000,000	1,000,000
	7,134,203	4,285,714
Less principal included in current liabilities (see (f) below)	1,107,928	369,114
	$6,026,275	$3,916,600

(a) The non-interest bearing agreement and the 8% agreement which arose pursuant to settlements of certain liabilities are unsecured (see note 8).

(b) The 10½% redeemable subordinated debentures are unsecured. For each $1,000 debenture the holder can require prepayment of $500 of principal for each 250 share purchase warrants exercised leaving $500 outstanding and due on October 31, 1980 (see note 5(c)).

(c) The term bank loans and the remaining debentures are secured by the company's fixed assets and by a floating charge on the company's undertaking and its other property and assets, both present and future, subject to the right of the company to deal with its property and assets in the ordinary course of business.

(d) The monthly payments on the 14¾% debenture for December 15, 1977 to March 15, 1978 inclusive were not made until March 15, 1978 and therefore the company was in default thereunder. On March 22, 1978 the 14¾% debenture holder advised the company that all defaults under the debenture had been waived and that as of March 22, 1978 the company was in good standing under the security documents. As referred to in note 1(e) the company will repay this debenture on May 1, 1978 with funds obtained from its bankers. The resulting term bank loan will be the same as the December 31, 1977 term bank loans with respect to interest rate, security and other terms except that it will be payable in forty-seven equal monthly instalments plus interest commencing in May, 1978.

(e) As referred to in note 1(d), the company has negotiated amendments to the terms of the 8% debenture such that the covenants are substantially the same as those of the security for the term bank loans. These covenants restrict the company (see note 5(a)) but do not otherwise restrict the company in its current operations.

(f) The long term debt is repayable as follows:

1978	$1,107,928
1979	1,784,248
1980	2,057,270
1981	1,237,308
1982	829,406
1983	118,043
	$7,134,203

Revenue earned under the terms of the agreement with DuPont (see note 6) will be available to repay the amount due in 1978.

5. CAPITAL STOCK

(a) According to the terms of the secured debentures the company may not, without prior written approval:

(i) declare or pay any dividends on or make any distribution in respect of its common shares,

(ii) make any changes in its authorized or issued capital stock except in the manner outlined in (b) and (c) below.

(b) The Class A shares are convertible into common shares on the basis of one common share for each two Class A shares converted.

(c) Share purchase warrants issued with the 10½% redeemable subordinated debentures entitle the holders thereof to purchase in the aggregate 187,500 common shares at a price of $2.00 per common share up to October 31, 1980.

(d) Dividends on Class A shares are in arrears at December 31, 1977 in the amount of $2.875 per share totalling $345,000. The date up to which dividends were last paid on Class A shares is March 31, 1973.

(e) Earnings (loss) per common share have been calculated after providing for the cumulative dividend entitlement of $60,000 on Class A shares.

Fully diluted earnings per common share would have been $.93 after extraordinary items based on 417,500 common shares calculated using the following assumptions at the beginning of the year:

(i) the conversion of all Class A shares into common shares,

(ii) the exercise of all share purchase warrants issued with the 10½% redeemable subordinated debentures resulting in an increase in earnings for the year of $22,837 after tax.

6. DUPONT AGREEMENT

As outlined in note 1(b) on June 22, 1977 the agreement with DuPont was renegotiated effective November 1, 1977 as follows:

(a) The company has committed its Cornwall processing facilities exclusively to DuPont for five years, with options by DuPont to extend the agreement. The company has no right of termination of the agreement. DuPont may terminate the agreement under certain specified circumstances.

(b) The company has agreed to use a particular portion of the cash received under this agreement for repayment of fixed asset financing. Of the cash received to December 31, 1977 the amount of $440,500 is thus restricted and of this amount $200,000 is further restricted under the amended provisions of the 8% debenture to cover part of the 8% debenture payment due December 15, 1979. Accordingly $240,500 is available toward the principal due within one year on long term debt.

(c) The company has agreed to expand the processing facilities at DuPont's request. To December 31, 1977 such requests have amounted to approximately $4,170,000 for the purchase of fixed assets of which $2,440,000 has been expended and approximately $1,730,000 remains to be expended.

7. COMMITMENTS

(a) The company rents land and buildings under a thirty-year lease agreement effective September 1, 1975 at an annual rent of $399,298 which rent may be adjusted depending on any changes in the lessor's financing arrangements. A lease is being negotiated with respect to the lessor's additions to the building completed November 1, 1977. A director of the company is the beneficial owner of 33.6% of the lessor company's outstanding equity shares.

(b) The company rents computer equipment under a lease, which expires in July 1981, at an annual rental of $28,041.

(c) At December 31, 1977 the company had commitments of approximately $720,000 for the purchase of fixed assets.

8. EXTRAORDINARY ITEMS

	1977	1976
Gain (loss) on disposal of fixed assets	$ 8,127	($189,663)
Gain on settlement of certain liabilities (see below)	248,869	
Income tax reduction realized on application of prior year's loss	32,041	
	$289,037	($189,663)

During 1977 the company negotiated settlements on certain liabilities. The most significant settlement arose with respect to royalties payable which resulted in a gain of $211,049. The total of such gains amounted to $248,869.

9. INCOME TAXES

The company has the following available in determining income taxes in future years, the tax effect of which has not been recorded in the accounts:

Excess of undepreciated capital cost over net book value of fixed assets	$934,210
Less other items deferred in the accounts but already claimed for tax purposes	41,988
	$892,222

10. THE ANTI-INFLATION ACT

The company is subject to the Anti-Inflation Act as it relates to the restraints on dividends until October 13, 1978.

11. COMPARATIVE FIGURES

Certain figures for 1976 have been reclassified in order to conform with the financial statement presentation adopted for 1977.

12. OTHER STATUTORY INFORMATION

Remuneration of directors and senior officers (as defined by The Business Corporations Act) amounted to $189,912 ($169,796 in 1976).

AUDITORS' REPORT

To the Shareholders of
RIVERSIDE YARNS LIMITED

We have examined the balance sheet of Riverside Yarns Limited as at December 31, 1977 and the statements of income, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Brockville, Canada
March 31, 1978

THORNE RIDDELL & CO.
Chartered Accountants